Franchise Tax Board

ANALYSIS OF AMENDED BILL

Author:	Dutton	Analyst:	Angela Raygoza	Bill Number:	SB 206
Related Bills:	See Legislative History	Telephone:	845-7814	Amended Date:	April 28, 2009
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: Principal Residence Credit

SUMMARY

This bill would provide a tax credit for a qualified principal residence, as specified.

SUMMARY OF AMENDMENTS

The April 28, 2009, amendments would do the following:

- Remove intent language that would make changes to the Insurance Code;
- Provide a maximum tax credit of $8,000 for the purchase of a qualified principal residence;
- Allow a taxpayer to reserve the credit, as specified;
- Define “qualified principal residence” and “qualified taxpayer;” and
- Disallow credit if taxpayer fails to occupy residence as principal residence for at least three years immediately following purchase.

This is the department’s first analysis of this bill.

PURPOSE OF THE BILL

According to the author’s office, the purpose of this bill is to stimulate the economy and restore the housing market.

EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would be effective immediately upon enactment and specifically operative for taxable years beginning on or after January 1, 2009, and before January 1, 2010, for taxpayers who purchase a qualified residence on or after January 1, 2009, and before December 1, 2009.

POSITION

Pending.

Board Position:			Department Director	Date
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ANALYSIS

FEDERAL LAW

Existing state and federal laws provide various tax credits designed to provide tax relief for taxpayers who incur certain expenses (e.g., child adoption) or to influence behavior, including business practices and decisions (e.g., research credits or economic development area hiring credits). These credits generally are designed to provide incentives for taxpayers to perform various actions or activities that they may not otherwise undertake.

First-Time Homebuyer's Credit

Housing and Economic Recovery Act of 2008 (Public Law 110-289)

A "first-time homebuyers" credit was enacted by the Housing and Economic Recovery Act of 2008. The Act added a new refundable tax credit for "first-time homebuyers." The amount of the credit is the lesser of $7,500 or 10 percent of the home's purchase price. The credit is phased out for taxpayers with adjusted gross income[1] (AGI) between $75,000 and $95,000 ($150,000 and $170,000 for joint filers). The credit applies to principal residences purchased after April 8, 2008, and before July 1, 2009.

The credit is recaptured under the terms of Internal Revenue Code (IRC) section 36(f) over 15 years with no interest charge, beginning with the second tax year after the tax year in which the home is purchased. If the home is sold before the 15-year period ends, the remaining credit must be recaptured in the year of sale.

American Recovery and Reinvestment Act of 2009 (Public Law 111-5)

The "first-time homebuyers" credit was modified by the American Recovery and Reinvestment Act of 2009. In general, for homes purchased after December 1, 2008, and before December 1, 2009, the maximum credit allowed is increased to $8,000 ($4,000 for married individuals filing separately). The credit is no longer required to be recaptured unless the taxpayer sells the qualified residence within 36 months. The credit applies to homes that are financed by exempt mortgage revenue bonds or located in the District of Columbia.

STATE LAW

Newly enacted state law, SBX2 15 (Ashburn, Stats. 2009 Third Extraordinary Session, Ch. 11), provides a tax credit in the amount of 5 percent of the purchase price of a qualified principal residence or $10,000, whichever is less. The credit is allowed for one purchase of a qualified principal residence by an individual and applies to purchases made on or after March 1, 2009, and before March 1, 2010. Within one week of the sale of the qualified principal residence, the seller is required to provide to the purchaser and to the Franchise Tax Board (FTB) certification that the residence has never been previously occupied.

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[1] Adjusted gross income, as defined by IRC section 62, means gross income, which includes all income from whatever source derived, adjusted for certain allowable amounts, including IRA contributions, alimony paid, moving expenses, and Keogh account contributions.

The tax credit is allocated by FTB with a maximum of $100 million. Upon receipt of certification from the seller, the credit is allocated on a first-come, first-serve basis. The credit must be claimed on a timely filed original return. The determination by FTB with respect to the date a certification is received, and whether a return has been timely filed, may not be reviewed in any administrative or judicial proceeding. Any disallowance of a credit claimed on the basis of exceeding the $100 million limitation is treated as a mathematical error and any tax resulting from such disallowance may be assessed in the same manner as applicable to mathematical errors. The newly enacted state law remains in effect until December 1, 2013, and is repealed as of that date.

Current state law limits the amount of allowable tax credits for each taxable year beginning on or after January 1, 2008, and before January 1, 2010, to an “applicable amount.” “Applicable amount” is equal to 50 percent of the tax before the application of any credits. Any disallowed credit remains a credit carryover to subsequent years and the credit carryover period is increased by the number of taxable years the credit amount was disallowed. Taxpayers with business income subject to tax of less than $500,000 are excluded from this law.

THIS BILL

For taxable years beginning January 1, 2009, and before January 1, 2010, this bill would provide a tax credit under the Personal Income Tax Law (PITL) to an individual who is a purchaser of a qualified principal residence. This bill would apply to purchases made on or after January 1, 2009, and before December 1, 2009. The amount of the credit would be equal to 10 percent of the purchase price of the residence, not to exceed $8,000.

Under this bill, an individual taxpayer would be allowed one credit for one purchase of a qualified principal residence.

This bill would allow taxpayers to reserve a credit prior to the close of escrow. To reserve the credit, the taxpayer and seller would be required to jointly sign and submit to FTB certification that the taxpayer and seller have entered into the agreement on or after January 1, 2009, and before December 1, 2009. FTB would be required to reserve the credit upon receipt of the certification.

This bill would define the following:

- “Qualified principal residence” as a new or previously unoccupied single-family residence, whether detached or attached, that is purchased to be the principal residence of the purchaser for a minimum of three years immediately following the purchase and is eligible for the homeowner’s exemption.[2]
- “Qualified taxpayer” means the buyer has not owned a principal residence during the three-year period prior to the date of purchase and does not have AGI over $95,000 or $170,000 for joint filers.

[2] California Revenue and Taxation Code (CR&TC) section 218, a homeowner’s property tax exemption is $7,000 of the full value of the dwelling.

This bill would disallow the credit if the taxpayer does not occupy the qualified principal residence as his or her principal residence for a minimum of three years immediately following the purchase. If the credit is disallowed, this bill would require the taxpayer to be liable for any underpayments attributable to the disallowance of the credit.

This bill would require the credit to be divided equally between taxpayers that file an income tax return as married filing separately. If two or more taxpayers are not married, but purchase a qualified principal residence, the amount of the credit allowed would be allocated between the taxpayers in the same manner as each taxpayer's percentage of ownership. The total amount of credits allowed to all of these taxpayers could not exceed $8,000.

Under this bill, FTB would be required to determine the date the certification is received from the taxpayer. The determinations made by FTB with respect to the date a certification is received, and whether a return has been timely filed, may not be reviewed in any administrative or judicial proceeding.

This bill would require that any disallowance of a credit claimed due to the date of certification would be treated as a mathematical error appearing on the return. Any amount of tax result from the disallowance would be assessed by the FTB in the same manner as a return with a mathematical error or erroneously omitted tax.[3]

This bill would allow FTB to prescribe rules, guidelines, or procedures necessary to carry out the purposes of this bill, including any guidelines regarding the allocation of the credit.

Under this bill, the credit allowed would be inapplicable as a business credit and would be excluded from the 50 percent credit limitation under newly enacted state law.[4]

This credit would be repealed as of December 1, 2010.

IMPLEMENTATION CONSIDERATIONS

The department has identified the following implementation concerns. Department staff is available to work with the author's office to resolve these and other concerns that may be identified.

This bill uses a term that is undefined, "certification." The absence of a definition to clarify this term could lead to disputes with taxpayers and would complicate the administration of this credit.

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[3] CR&TC Section 19051-Any amount of tax in excess of that disclosed by the return, due to a mathematical error, notice of which has been mailed to the taxpayer, and is not a deficiency assessment. The taxpayer has no right of protest or appeal based on that notice; however, the amount of tax erroneously omitted in the return may be assessed and collected in the manner provided in this part as in the case of deficiency assessments.

[4] AB 1452 (Committee on Budget, Stats. 2008, Ch. 763) limits the amount of allowable "business credits" to an applicable amount. Applicable amount" is equal to 50% of the tax before the application of any credits. Any disallowed credit remains a credit carryover to subsequent years and the credit carryover period is increased by the number of taxable years the credit amount was disallowed.

This bill would allow the taxpayer to reserve a credit prior to the close of escrow. Generally, credits that have an allocation cap can be reserved to guarantee the taxpayer receives the credit before the maximum allocation is reached. Because this bill lacks a maximum allocation for the credit, taxpayers who purchase a residence between January 1, 2009, and before December 1, 2009, and claim the credit on the return for the taxable year would receive the credit. It is recommended the author amend the bill to clarify the intent of the credit reservation to avoid confusion.

This bill would require the FTB to determine the date certification is received from the taxpayer; however, the date of certification would not impact the eligibility for the credit. It is unclear if the certification is the reservation for the credit or another piece of certification required by the taxpayer. If the author's intent is to require certification to verify the taxpayer has not purchased a principal residence three years to the date of purchase, it is recommended the bill be amended to specify this requirement.

This bill would disallow the credit if the taxpayer fails to occupy the qualified residence for at least three years following the purchase of the residence. It is unclear how the department would determine if a taxpayer fails to occupy the residence for a minimum of three years after the purchase. Typically, credits involving areas for which the department lacks expertise are certified by another agency or agencies that possess the relevant expertise. It is recommended that the bill be amended to provide certification language. The certification language would specify the responsibilities of both the certifying agency and the taxpayer. The language should also require that the certification be provided to the department upon request.

In addition, the bill is unclear if the $8,000 credit applies to individuals and to married individuals filing joint. If two married individuals purchase the same residence, the language could be interpreted to allow each married person a credit of $8,000 for a total of $16,000. If this is not the author's intent, it is recommended bill be amended to clarify the tax treatment for married individuals.

<u>TECHNICAL CONSIDERATIONS</u>

Amendment 1 has been provided to correct a technical error.

LEGISLATIVE HISTORY

SB 49 (Dutton, 2009/2010) would allow a maximum credit of $10,000 of the purchase price for purchases made on or after March 1, 2009, and before March 1, 2010, on a qualified principal residence. This credit does not have a maximum allocation. This bill is currently in the Senate Revenue and Taxation Committee.

SBX 2 15 (Ashburn, Stats. 2009 Third Extraordinary Session, Ch. 11) allows a $10,000 credit for the purchase of a qualified principal residence for purchase made after March 1, 2009, and before March 1, 2010. The credit is being allocated by FTB with a maximum allocation of $100 million.

OTHER STATES' INFORMATION

Florida, Illinois, Massachusetts, Michigan, Minnesota, and *New York* laws do not provide a credit comparable to the credit allowed by this bill. The laws of these states were reviewed because their tax laws are similar to California's income tax laws.

FISCAL IMPACT

The department's costs to administer this bill cannot be determined until implementation concerns have been resolved but are anticipated to be minor.

ECONOMIC IMPACT

Revenue Estimate

This bill would result in the following revenue losses.

Estimated Revenue Impact of SB 206 As Amended April 28, 2009 Effective with Taxable Years Beginning On or After January 1, 2009, and Before January 1, 2010 Enactment Assumed After June 30, 2009 ($ in Millions)		
2009-10	2010-11	2011-12
- $280	$0	$0

This analysis does not consider the possible changes in employment, personal income, or gross state product that could result from this bill.

Revenue Discussion

The number of qualified taxpayers who purchase a qualified principal residence and the amount of credits that can be applied to reduce tax liabilities would determine the revenue impact of this bill. The qualified principal residence must serve as a primary residence and be purchased on or after January 1, 2009, and before December 1, 2009.

Based on historical data from the California Association of Realtors and using growth projections for total home sales by Department of Finance, homes sales are estimated to be approximately 584,000 in California during 2009.

The number of projected home sales was reduced for the following:

- To exclude unqualified taxpayers who have owned a principal residence during the three-year period prior to the date of purchase and who have AGI over $95,000 for single filers, and $170,000 for joint filers,
- To exclude investment purchases, and
- To exclude sales made in December of 2009.

Therefore, to arrive at an estimate of qualified taxpayers, projected home sales would be reduced by two-thirds to approximately 195,000 [584,000 homes sales in 2009 x (1 – 67%)]. Home sales are limited to those made on or after January 1, 2009, and before December 1, 2009. In addition, projected homes sales would be further reduced to exclude sales during the month of December. December's home sales would be approximately 5 percent of annual sales. This would reduce qualified home sales by 5 percent to approximately [185,000 (195,000 x (1-5%)].

To account for purchases of a principal residence for less than $80,000, for example, condominiums, manufactured homes, fabricated homes, etc., it is assumed the average credit generated would be $7,500.

During tax year 2009, credits generated would be estimated at approximately $1.4 billion (185,000 purchases x $7,500 credit amount). Of this $1.4 billion, it is assumed that taxpayers would have sufficient tax liability to use 20 percent of available credits. The revenue loss would be estimated to be approximately $280 million ($1.4 billion x 20%). Because the credit is non-refundable and has no carryover provision, taxpayers must claim the credit to reduce their tax liability on a timely filed original return. The full revenue loss of $280 million would be only in fiscal year 2009-10.

POLICY CONCERNS

Because this bill fails to specify otherwise, a taxpayer could potentially claim the credit proposed by this bill and the newly enacted Qualified Purchase Residence Credit SBX2 15 (Ashburn, Stats. 2009 Third Extraordinary Session, Ch. 11). Generally, a credit is allowed in lieu of any deduction or credit already allowable for the same item of expense to eliminate multiple tax benefits.

The bill does not provide for the carryover of any unused credits. As a result, any credit in excess of a taxpayer's liability for the 2009 taxable year will not be used.

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FRANCHISE TAX BOARD'S
PROPOSED AMENDMENTS TO SB 206
As Amended April 28, 2009

AMENDMENT 1

On page 2, line 35, after "disallowance" insert:

of the